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COMMISSION ON TRANSNATIONAL CORPORATIONS
Intergovernmental Working Group of
Experts on International Standards
of Accounting and Reporting
Tenth session
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Agenda item 5

ADOPTION OF THE REPORT OF THE GROUP ON ITS TENTH SESSION

Draft report

Addendum

Rapporteur: L. Nelson Carvalho (Brazil)

II. PROGRAMME OF WORK OF THE INTERGOVERNMENTAL WORKING GROUP OF EXPERTS ON INTERNATIONAL STANDARDS OF ACCOUNTING AND REPORTING

B. Discussion of accounting issues arising during privatization, including individual country case-studies

At its 5th, 6th, 7th, 8th and 9th meetings, on 9, 10 and 11 March 1992, the Group had before it the report of the Secretary-General containing a summary of the accounting and reporting problems identified in the reports of case-studies on seven countries (E/C.10/AC.3/1992/5). The reports contained a description of each Government's objectives for privatization, a discussion of the privatization methods, a description of how the privatization methods were implemented, and a review of the accounting problems that arose during the privatization programme. A distinction was made between privatization in countries that had established market economies with related legal infrastructures and financial institutions and countries that were in transition to a market economy. In general the experts were pleased with the quality of the reports, and minor amendments, proposed by the national experts, were incorporated into the reports.

The expert from the United Kingdom commented that the power generation and distribution industries had also been privatized. The privatization programme was incomplete and would continue with the privatization of the coal industry and railways. Several experts inquired about the difficulty of using current cost information to establish the fair value of the enterprises privatized. The expert from the United Kingdom replied that while the current cost accounting information was useful, it did not represent the equivalent of a valuation performed by an independent appraiser for the purpose of establishing a purchase price. Another question related to the low selling price of some share offers. The expert from the United Kingdom explained that an objective was to promote private ownership of shares, and to encourage participation, shares were issued on attractive terms. Incentives given included payments by instalments, the issue of vouchers for consumption of services, and participation in future bonus issues.

Another expert asked how share offerings of an enterprise were priced after the initial offering - at the book value of the shares, the stock exchange market value, or the economic value - that is, the present value of future cash flows from the operations of the enterprise. There was concern that the original value of the shares owned by the shareholders might be diluted. The expert from the United Kingdom replied that subsequent to issue, shares were quoted at market values and shareholders were entitled to purchase a proportional interest in future offerings so that their interest in an enterprise was not diluted. Those rights were also traded on the stock exchanges.

Another expert inquired whether privatization of an enterprise that had a monopoly in the country affected the cost of goods and services sold by the enterprise. The United Kingdom expert stated that special regulatory bodies were established (i.e., Office of Telecommunications) to ensure that prices charged for goods and services were fair and reasonable.

The expert from France informed the Group that the privatization programme in that country, which had actually begun in 1973, with employees of some financial enterprises being given free shares, was still incomplete. He mentioned two important problems: the determination of the value of the enterprise, and the nature and scope of the audit. On the question of valuation, he noted that the going-concern value of a total enterprise was usually greater than the value of the net assets. Normally, a range of financial values was attributed to an enterprise by investment advisors and appraisers. That range was useful in assisting the Government minister to determine an appropriate global valuation and an issue price. He noted that the global value of the enterprise usually exceeded the aggregate value of its individual shares because each shareholder had limited control and power. He mentioned that different methods were used in selling shares. For example, large blocks of shares were sold to institutional purchasers, who paid higher prices and agreed to retain them for specified periods.

The second issue raised related to the function of auditors, who had a very important role in the process, because the Government required the

preparation of consolidated financial statements in accordance with international standards for each enterprise being privatized. Those financial statements were required to be audited.

One expert asked whether selling prices for enterprises were ever regarded as too low. The expert from France replied that that had occurred, but that the Government's intention was to promote a broad ownership of shares in that country, and that objective had been attained. Two other experts questioned the reasons for the Government's setting aside the proceeds from the privatizations in separate budgetary accounts. The representative from France stated that that was done to provide funds for future investments in the French economy. In replying to another question the French expert pointed out that in some instances the Government retained control of the privatized enterprises.

The expert from Mexico presented the important aspects of the privatization programme in his country which had been motivated by the financial crisis of 1982. At that time, there were 1,550 State-owned enterprises, compared to 200 enterprises in 1992. Most of the remaining State enterprises were in priority sectors of the economy, where private ownership was prohibited by the Constitution.

Although some difficulties had been experienced, important lessons had been learned. First, it was found that it was better to privatize small enterprises before large ones in order to minimize the impact of mistakes and to develop experience in the privatization process. The expert emphasized the importance of having a legal framework to provide complete transparency for the process, centralized control of the privatization programme, and where necessary, the restructuring of enterprises before sale. In Mexico, privatization sales were on a cash basis, because the transactions were regarded as irreversible once concluded. The need for transparency in transactions and communication about the programme was important not only for the citizens of the country but also for the foreign investment community.

One expert inquired about the qualifications of commercial banks as agents for privatization transactions. The expert of Mexico replied that the banks were well qualified to perform appraisals. A question was raised about the difficulties of meeting the requirements of listing on the United States and European stock exchanges. The expert from Mexico responded that that was not a significant problem, because the enterprises involved followed international standards of accounting in the preparation of their financial statements.